Internal Revenue Service

memorandum

CC:TL
Br4:JTChalhoub

date: June 13, 1986

to: District Counsel, Kansas City MW:KCY

from: Director, Tax Litigation Division CC:TL

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subject: [redacted]

This is in response to your April 25, 1986, request for technical advice in the above case. You resolved the immediate problem in [redacted], as indicated in a telephone conversation on May 21, 1986, between Messrs. Bowman and Chalhoub, by executing a stipulated decision that included a reservation paragraph (below the Judge's signature) providing for the possible later recapture of an excess tentative allowance under I.R.C. § 6213(b)(3). You used a paragraph, similar to the sample contained in Exhibit (35)(10)00-29(a) Tentative NOL Not in Issue, as found on page (35)-429 of the CCDM (Tax Litigation Division Manual). Although the immediate problem in [redacted] has been resolved, you see that issue and related problems to be of a continuing nature and ask advice concerning appropriate Counsel position in processing Tax Court cases to conclusion that involve previous allowances of tentative carrybacks.

ISSUE

With respect to a taxpayer's carryback year, if:

(1) a tentative carry back has been allowed;

(2) a notice of deficiency has been sent for the carryback year without determining the merits of the carryback adjustment from the source year;

(3) the taxpayer has filed a petition in the Tax Court; and

(4) neither the taxpayer nor the Service has raised the carryback issue with the Court;

should the stipulated decision of the Tax Court include a reservation paragraph with respect to the right of the Service to make a summary assessment with respect to the carryback under I.R.C. § 6213(b)(3)? 6213.07-02.

CONCLUSION

Where the district director (or Appeals) must issue a notice of deficiency with knowledge of a previously applied tentative allowance, but without making a determination as to its correctness, it may be preferable for that notice to not include any reference to such allowance in order to undercut taxpayer's legal argument that the Tax Court decision is res judicata with respect to the carryback adjustment. We are moving in unchartered territory and the CCDM and exhibits provide that it is necessary for decision documents to reference a carryback if there is any indication the issue has been raised. To fully protect the Service's interest, it is best to include a stipulation that recapture may be made under I.R.C. § 6213(b)(3) even when the carryback issue was not raised.

DISCUSSION

You are familiar with the position taken in O.M. 19801, [redacted], dated December 17, 1983. In effect, the present position of the Chief Counsel is that a notice of deficiency for the carryback year should in every case await an examination of the source year and a determination by the Service concerning the correctness of any previously allowed tentative carryback. This is the general rule to be followed.

You are also familiar with the position we took in [redacted] in our technical advice, dated October 21, 1981. In that memorandum, we referred to the Service's instructions contained in I.R.M. 42(11)(10).5 (1-29-80) that similarly instructed examiners to audit the source or loss year before completing an examination for the carryback year. A copy of the current provisions of the I.R.M. concerning tentative allowances is attached for your information. You will note that I.R.M. 42(11)(10).5 (4-18-86) has expanded the original instruction to examiners, but maintains the same general rule and exception for "large cases" under the Coordinated Examination Program.

The I.R.M. exception for "large cases" presents litigation hazards that may result in our trial attorneys being required to assume a burden of proof with respect to the merits of a later disallowed carryback adjustment. We are attaching a copy of our recent technical advice in [redacted], dated April 30, 1986, which discusses in some detail, the hazards of issuing a notice of deficiency without making a final determination with respect to the correctness of a tentatively allowed investment credit carryback. That advice also warns of the possible finding of res judicata by a district court where any reference to or mention of a tentative allowance is included (by stipulation or otherwise) in prior Tax Court documents or in the notice of deficiency on which the suit is based.

We agree with you that a decision document need not, but may, determine the amount of a carryback where the tentative allowance has been made after the notice of deficiency. However, where either party raises the issue of the carryback in his pleadings the decision document must include a determination on the merits of the carryback adjustment.

Pursuant to Midland Mortgage Co. v. Commissioner, 73 T.C. 902 (1980), it makes no difference which method the Service uses to recapture an excess carryback adjustment. However, the legislative history supports the position that we will use the deficiency procedure wherever possible. See House Rept. 849 accompanying H.R. 3633, 79th Cong., 1st Sess., 1945 C.B. 566, at page 583, wherein it is stated with respect to 1939 Code § 3780(c) the predecessor of 1954 Code § 6213(b)(3) as follows:

> It is to be noted that the method provided in subsection (c) of section 3780 to recover any amounts applied, credited, or refunded under section 3780 which the Commissioner determines should not have been so applied, credited, or refunded is not an exclusive method. It is contemplated that the Commissioner will usually proceed by way of a deficiency notice in the ordinary manner, and the taxpayer may litigate any disputed issues before the Tax Court. The Commissioner may also proceed by way of a suit to recover an erroneous refund. [Emphasis supplied.] Cf. G.C.M. 34288, Utilization of Section 6213(b)(2) (Assessment Arising Out of tentative Carry Back Adjustments) I-3495, May 6, 1970.

As you indicate, reasonable minds may, and indeed do, sometimes differ on the position to be taken for the Commissioner in addressing this issue. We cannot agree, in the present circumstances, that the computation method of a deficiency for the notice and the computation method of the deficiency for the decision document must always be the same. If the notice of deficiency does not include disallowance of the carryback and the issue is raised (after summary assessment and payment) by the taxpayer in the Tax Court case, the decision document, stipulated or otherwise (i.e. Rule 155), must include a determination with respect to the carryback. See CCDM (35)(10)62(5) and (6). This is necessary whether the notice of deficiency treated the tentative allowance as a rebate or not.

You state "the right to proceed under section 6213(b)(3) is precluded when the amount of the carryback is determined in the prior Tax Court case," citing Fluor v. United States, 79-1 U.S.T.C. 9393 (C.D. Cal. 1979). In Fluor as well as in Hanson Clutch and Machinery Co. v. United States, 72-1 U.S.T.C. 9303

(N.D. W.D. Ohio 1972), both of which were refund suits, the issue was whether the prior Tax Court decision included a "determination" with respect to the carryback adjustment. That issue is a question of fact to be resolved from the record in the prior Tax Court case. There is no "preclusion" as such, until a court finds as a fact that the prior Tax Court case is res judicata on the issue of the carryback adjustment. Accordingly, the proper statement should be "the right to proceed under section 6213(b)(3) may be precluded by a finding of the district court that the amount of the carryback adjustment was determined or subsumed in the decision of the prior Tax Court case."

We are unpersuaded by the authority you cite, such as the Roberts and Spohren cases. While these cases support the general proposition you cite them for, these cases do not necessarily apply to the issue of res judicata with respect to carryback adjustments. The reason is there are separate statutory provisions which lift the bar of res judicata for the taxpayer under appropriate circumstances. See e.g. I.R.C. § 6511(d)(2)(B)(i).

We hope this advice has been responsive to your request. If you have any questions concerning this matter, please contact Joseph T. Chalhoub at FTS 566-3345.

ROBERT P. RUWE
Director

By: _____
HENRY G. SALAMY
Chief, Branch No. 4
Tax Litigation Division

Attachments:
Copy IRM 42(11)(10)
Copy of T/A [redacted]
Copy of G.C.M. 34288